Retail Services Business Plan

Washington State
Liquor Control Board

July 2002

PLAINTIFF'S EXHIBIT
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There may be other LCB employees and stakeholders who contributed to the development of this plan whose names we have missed. We apologize, and thank these unnamed partners for their valuable time and expertise.

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EXECUTIVE SUMMARY

The Washington States Liquor Control Board (LCB) operates a half billion plus dollar a year retail and wholesale business. This business has continued to show sales increases over the years and contributed millions of dollars in revenues to state and local governments.

The LCB's new management team is developing a clear focus for the future of its Retail Services operations. This focus has evolved during the past several months as the LCB has developed its Strategic Plan and Retail Services Business Plan. With the collective efforts of LCB personnel and stakeholders, the emphasis of these planning processes has been to take Retail Services operations to new thresholds of accomplishment by using best business practices and by focusing on maximizing revenues, providing excellent customer service, and responsibly controlling the distribution of alcohol. Combined, these two plans are setting the future course for Retail Services and the other divisions of the agency.

While historically the agency has not always had this focus, and continues to operate with a number of constraints, this Business Plan outlines specific ways to improve its operations. This refocusing is occurring at a time when the industry itself is changing. Sales growth is occurring in particular segments of the market while other segments are declining. Paying attention to industry and population trends and customer profiles is becoming more important as niche markets become the driver of the industry's growth opportunities. Operating smarter and more efficiently are keys to the LCB's future businesses success and its ability to generate returns for the taxpayers of the state of Washington.

The plan is to focus on the basics of running a good business. The opportunities in this plan address how the LCB balances revenue generation to the state with its responsibility to effectively control the distribution and retail sale of alcohol. Over eighty LCB staff and other industry experts developed the strategies which are included in this plan. Some highlights include:

<u>Management tools</u>:
Having good information is essential for making good management decisions. A tremendous leap forward in having access to transaction data at the store level for state-operated stores will be accomplished by June 2003 when a new Merchandising Business System (MBS) becomes functional. Implementation of the MBS will support decision-making at all levels and all aspects of the operation. With MBS in the near future, plans are already underway to begin the process of setting goals at the store level and beginning to change the focus of the operation to a more business-oriented approach. Long-term, these basic steps will be complimented by exploring employee incentive

programs based on performance and extending the MBS to contract stores so there is one data-gathering and reporting system for all stores.

Retail and wholesale revenue enhancement opportunities:

For retail sales, there are three major focuses for enhancing revenue. The first is to relocate the least profitable stores once performance standards are developed to identify stores that are not contributing at minimum standards. The second is to open several new state-operated stores in high growth areas to take advantage of market opportunities that do exist. In addition, the possibility of opening one or more pilot contract liquor stores that incorporate performance standards into the contract will be explored. Developing store siting and leasing strategies consistent with best business practices will be a key component in implementing these two strategies.

The third strategy is to sell liquor-related accessories in state-operated stores. This would enhance customer service while providing an opportunity to increase sales margins.

For wholesale sales, the possibility of creating a web-based ordering system for licensees will be explored. In addition, options for outsourcing delivery programs for liquor licensees in urban areas will be supported if there is sufficient demand for this service.

Merchandising and purchasing:

Consumer and product research indicates the industry is changing, and consumer buying habits vary due to many factors. This reinforces the need to monitor trends closely, purchase and merchandise wisely, be knowledgeable about products, and provide great service to a more demanding customer. In addition to implementing the MBS (which will be a source of a tremendous amount of information), there is a need to have an effective merchandising program that takes advantage of research done by the industry on customer buying habits and product mix and display. A key element is to create a merchandising manager position to develop category management and shelf-management programs that are supported by industry-specific software. Combined, these efforts will help increase sales by using best business practices and fully using available industry research.

In addition to creating a merchandising program, a number of other opportunities are being considered that will support purchasing decisions and manage inventory levels most efficiently. While specifics are outlined in the plan, two significant goals have been established in this area:

1. Reduce the Cost of Goods Sold by 1% during the next biennium, from 71.5% to 70.5%
2. Increase inventory turns from 9.55 to 10.5 by the end of the biennium.

Accomplishing these goals will directly affect bottom-line results.

Distribution:

The new Distribution Center opened at its Seattle location this spring with a new automated material handling system. The material handling system is functioning and meeting its off-peak season daily shipping demands. The vendor will implement solutions by the end of September 2002 to address the operational needs of the LCB during the holiday season and for anticipated growth in wholesale and retail operations.

Labor needs associated with operating and maintaining this system due to increasing shipping demands, particularly during the holiday season, are an issue and are being addressed through a decision package request for the 03-05 biennium.

Having a reliable and responsive distribution system is essential to the success of the overall operation. As such, several strategies are outlined in this plan to support this goal.

Customer service:

Another essential aspect of the business is to be responsive to customers, particularly in a changing environment. Ways of obtaining customer feedback are addressed in this plan. The goal is to have and maintain high customer service expectations in all aspects of the operation.

Summary:

To implement all of the proposals presented in this plan, a $3,429,082 investment is needed. The estimated return in increased net income and taxes collected through Fiscal Years 03-05 is projected at $16,210,575. In addition, other proposals and strategies will continue to be evaluated.

This Retail Business Plan will continue to be reviewed and evolve as the environment changes and as more or new information becomes available. At a minimum, the LCB will review this plan quarterly and update the plan annually.

Chapter I: History

Overview:

Over the past 68 years, the Washington State Liquor Control Board (LCB) has provided more than $4 billion to state and local budgets through the sale and distribution of alcohol beverages. In Fiscal Year 2002, the LCB distributed over $220 million to state and local governments from profits, taxes, and license fees imposed on the sale of spirits, wine, and beer.

The LCB has a long history as a revenue generator for the state. In 1933, after twelve years of prohibition, the 21st Amendment to the U.S. Constitution ended prohibition and provided states complete authority to regulate the distribution and sale of liquor. That same year the Washington State legislature passed the Steele Act, creating the Liquor Control Board. Under the Steele Act, tight control of liquor distribution was established through state ownership of liquor stores and strict regulation of privately owned restaurants, stores, and dispensaries that sell beer and wine.

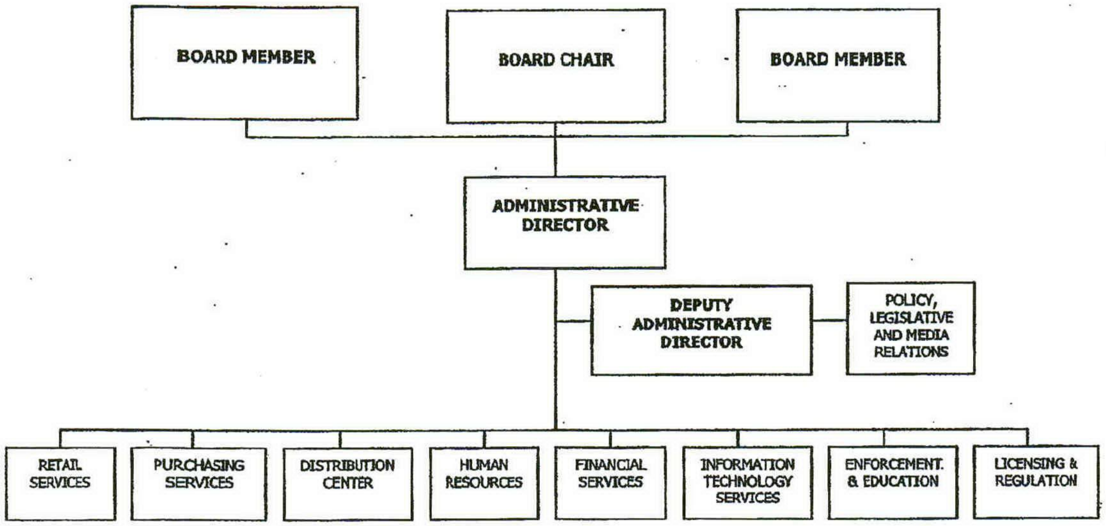
By the end of 1934, the Liquor Control Board had 46 state-operated stores and 105 contract liquor stores. Over 6,400 retailers were licensed to sell beer and wine. Today, Washington has 157 state-run stores, 155 contract liquor stores, and over 12,000 liquor-licensed premises throughout the state. The state-run and contract liquor stores generate over one-half billion dollars in gross sales annually.

Washington is one of eighteen states that chooses to directly control the sale of liquor at the wholesale level. Fourteen of these states, including Washington, also choose to control retail sales, which requires citizens to purchase liquor at a state-run or designated contract liquor store. These eighteen states collect taxes and profits from the sale of liquor and remain "control states" to this day.

The LCB is administered by a three-member Board appointed by the Governor and confirmed by the Senate for six-year staggered terms. An Administrative Director manages the daily operations of the agency. The following three divisions are directly related to the operation of the retail stores. These combined operations are the focus of this business plan:

1. Retail Services
2. Purchasing Services
3. Distribution Center

These three divisions are supported by the other divisions of the LCB. Following is an organizational chart of the agency.



Mission Statement:

The mission of the Liquor Control Board is to serve the public by preventing the misuse of alcohol and tobacco through controlled distribution, enforcement, and education; and provide excellent customer service by operating efficient, convenient retail stores.

Strategic goals:

The LCB has also developed the following strategic goals:

1. Promote public safety by ensuring compliance with liquor and tobacco laws and regulations through effective enforcement and education
2. Promote public trust
3. Maximize revenues to the state's taxpayers
4. Streamline and create effective business practices
5. Develop, recruit, retain, and value a high quality diverse workforce
6. Deliver quality and efficient services and information through improved technology

7. Strengthen partnerships with customers, stakeholders, and communities
8. Strengthen the agency's risk management loss prevention policies and practices

Business plan development:

The Retail Services Business Plan has been developed within the context of the LCB's mission and strategic goals. This Business Plan is a guidebook for the agency's retail operations and progress reviews. Course corrections will be made to this plan as circumstances change, or as more or different information becomes available. This is an evolving document and will be reported against quarterly and updated annually, consistent with the agency's review and update of its strategic plan.

The Business Plan is a guidebook for the agency's retail operations and progress reviews.

In order to most effectively incorporate the expertise of the agency's employees at all levels of the organization, seven teams were formed to develop the components of the plan. The focus of most of these teams was to develop investment and operating strategies that result in the Retail Services operations being a standard bearer in the industry, using best practices, and providing quality customer service whether it be through state-operated or contract liquor stores. In total, over 80 people from within the agency were involved in developing the specifics of the plan. In addition, input on the components of this plan was sought from the agency's Business Advisory Council and from other stakeholders.

Milestones:

The LCB and its Retail Services Division strive to maximize the return on investment to taxpayers while at the same time provide quality customer service. During the past ten years, the following milestones occurred, which illustrate the review and continuous evolution of the operations:

- 1994 Special Order Program by store managers initiated
- 1995 Contract store managers no longer considered state employees
- 1996 Wine Program introduced
- 1997 Agency Website launched
- 1997 Credit/debit card program implemented
- 1998 Enhanced technology & communications within agency launched
- 1999 Deloitte and Touche produce study of LCB's retail operations
- 1999 Washington State University's customer survey completed

- 2000 Governor's Retail Task Force established, submitted final report in December, 2000
- 2001 Wholesale-only outlet opened in Seattle
- 2000-02 Significant agency reorganization:
  - 2000--Administrative Director position created to direct day-to-day agency operations
  - 2002--Board Members reduce working hours to 60%
  - 2002--Business Advisory Council formed
- 2002 New Distribution Center opens
- 2002 New Retail Services Director hired
- 2002 New Management Business Systems (MBS) vendor is selected

The information garnered from previous reviews and plans is incorporated into this plan. In many cases the above milestones represent the implementation of recommendations from past plans or reviews. This 2002 Retail Services Business Plan presents a guidebook for the next three years and beyond based on best business practices and the practical and well-seasoned knowledge of experts in the industry.

Chapter 2: The Marketplace and Operating Environment

This chapter discusses marketplace trends and their effect on Liquor Control Board (LCB) Retail Services operations. Proposals and ideas presented in subsequent chapters have been evaluated against, and are consistent with, the historical and projected trends and customer demographics summarized in this chapter.

The recession and economic trends:

Washington State's economy is in a recession. While the national economy is already showing signs of rebounding, the Washington State recovery is expected to be unusually slow. The 2002 forecast for taxable retail sales in the state is negative 3.2%. For the succeeding three years, the Washington State Forecast Council has projected modest increases of 4.4% to 5.5%.

A review of liquor sales during recessionary times in Washington State shows that they hold steady, if not experience small increases. After the state's 1982-83 recession, liquor sales experienced a small decline. It is not clear if this is a pattern. The LCB's gross sales increased 6% between Fiscal Year 2000 and 2001. A 4% growth is expected for this Fiscal Year ending June 30, 2002. The revenue estimates recently presented to the Forecast Council project a 2.9% growth rate this upcoming fiscal year and 2.33% growth for each of the following two fiscal years, assuming no change in operations.

Consumption trends:

With the changes in the economy in the past twelve to eighteen months, the liquor industry is also experiencing change. Industry research indicates that about two-thirds of the U.S. adult population consume beverage alcohol. The majority of people who drink do so lightly or moderately. However, 10% of all American drinkers consume 57% of the entire U.S. market.

Market research also indicates that while certain product areas are showing growth, such as the wine market and premium distilled spirit blends, the overall consumption of alcohol has been declining for the past several decades (see "Product Trends" section on page 3 for more information). Factors affecting this trend include:

- Stricter legislation against drunk driving
- Stricter legislation against the sale of alcohol to minors
- Interest in more healthy lifestyles

Between 1987 and 1997, the Bureau of Labor Statistics reported the average annual consumer expenditures on alcohol beverages dropped 24%, from $408 to $309.

However, there are some industry experts who believe that this trend will start to change and take an upward swing in the next several years as the children of baby boomers reach drinking age, creating a "baby boom echo" effect.

Consumer profile:

Age, gender, education, and income are all factors that affect buying patterns for alcohol beverages. Some of the significant factors include the following:

- Baby boomers are aging. Everyday more than 10,000 people in the U.S. turn 50, and this trend will continue through 2014. People over 50 have more than half the nation's disposable income. Seventy-four percent of Americans with incomes over $50,000 drink alcohol. Older drinkers tend to choose distilled spirits and wine over beer. As this population segment continues to increase, it is expected these buying trends will continue.
- Increasing wealth is creating a more mainstream market for luxury items. In addition, two-income families significantly contribute to the increasing wealth. More affluent consumers spend disproportionately more on alcohol beverages and drive growth in premium categories.
- People are more educated than ever before. Seventy-six percent of college graduates drink.
- The young adult population, a group that tends to purchase more beer, has been stagnant for a number of years but is projected via the "baby boom echo" to grow in the current decade. Projections indicate the legal drinking age population in Washington State will grow almost 20% between 2000 and 2014. The impact of this growth in drinking age adults will put more pressure on retail liquor store penetration levels.
- The growth in households without children sets the stage for a positive alcohol beverage climate.
- While people who consume alcohol are more likely to be males and to be younger than 65 years of age, women represent a growth niche as they earn more money.
- Consumers live at "warp speed" and are ever more demanding. Retail services are in general experiencing a more complex consumer with heightened expectations.

Product trends:

As with consumer niches, some products are experiencing growth while others are flat or declining in market share. For instance, while beer is the most popular alcohol beverage in the country, it is losing market share to wine, while consumption of hard liquor is basically flat (except for some premium brands). This shift in consumption patterns is summarized in the following chart.

Preferred Beverages of U.S. Drinkers

Year	Beer	Wine	Liquor	Enjoy All Equally
1992	47%	27%	21%	3%
1994	41%	29%	18%	3%
1996	46%	27%	20%	6%
1997	45%	32%	18%	4%
1998	42%	34%	19%	4%

Gallup Poll, September 1999

Washington State liquor store trends are fairly consistent with national trends. However, Washington consumers' preference for wine tends to be higher than it is nationally, while it tends to be somewhat lower for beer. Research provided by the Washington Restaurant Association indicates that wine is most popular in the Pacific region compared to all other regions of the country. For example, in the Pacific region 55% of alcohol consumers drink wine when dining out.

The trend of "buying up" to more expensive brands is represented in Washington liquor stores. Over the last twelve months, the highest growth category for spirit case sales is in premium products, as the chart below illustrates.

LCB Distilled Spirit Sales Trends

	Largest Growth Categories Case Sales		
	5/00 - 4/01	5/01 - 4/02	% Increase
Flavored Vodka	3,514	4,911	36%
Flavored Rum	6,747	8,273	23%
Cognac	1,970	2,343	19%
Scotch, Single Malt	1,735	1,970	14%
Gift Sets	31	35	13%

The same trend is true with wines. High-end wines are the fastest growing category. Estimated sales of wines retailing at $25 and up are exceeding 25% annual growth.

Actual sales of spirits, wine, and beer through 2001 by gross dollar sales and liters sales are presented below. Since 1998, sales increases in spirits have been fairly steady. Wine sales experienced large increases in 1998 and 1999, primarily as the result of the focused efforts of the LCB's Wine Program Manager that was hired in 1996. Since this large growth spurt, wine sales have predictably leveled off.

Ciders and malt beverages represent a small portion of total sales, and tend to have inconsistent sales patterns that are driven by product introductions and supplier promotions. Ethyl alcohol sales are also a small percentage of total sales and have a specific market niche of sales to hospitals, clinics, etc.

WSLCB Sales Trends 1998-2001

	1998	1999	2000	2001
Dollar Gross Sales (percent increase/decrease)				
Spirits	5.66%	4.53%	7.38%	6.40%
Wines	19.74%	12.18%	9.03%	2.61%
Cider*	185.69%	103.26%	-70.29%	-23.12%
Malt	-3.60%	-3.15%	-39.56%	10.26%
Alcohol	8.15%	4.74%	-18.06%	-31.34%
Liter Sales (percent increase/decrease)				
Spirits	2.26%	2.79%	4.07%	2.04%
Wines	10.65%	6.80%	-3.90%	-4.16%
Cider*	232.55%	118.58%	-80.21%	-22.95%
Malt	-10.80%	-6.93%	-45.42%	12.95%
Alcohol	4.28%	6.03%	16.42%	6.43%

* *The cider category was created in 1996, per a change to the beverage alcohol tax law. Prior to 1996, most cider products were taxed at the rate for wines, which is a substantially higher tax rate.*

In Washington, sales in gross dollars have outpaced liter sales, which is consistent with the national trends of people "buying up." At the same time, consumer and product research reinforces the notion that particular niche markets provide growth opportunities, at least in the foreseeable future. This reinforces the need to monitor trends closely, purchase and merchandise wisely, be knowledgeable about products (particularly higher end items), and provide great customer service to a more demanding customer.

> Niche markets provide growth opportunities. This reinforces the need to monitor trends closely, and purchase and merchandise wisely.

As our population continues to mature, customer accessibility and convenience will become even larger factors in the operation's ability to be responsive to customer expectations. These trends, combined with the state's continued population growth, mean that careful selection of new outlet locations and models will also be important to maintain market penetration levels and maximize revenue generating opportunities.

Drinking age population increases while number of liquor stores decline:

The number of liquor stores has declined since the 1980s, and the drinking age population has increased.

In 1990, there were 3,387,536 adults age 21 and over in Washington State. By 2001, this number grew to 4,195,119, reflecting a 23.8% increase within this population.

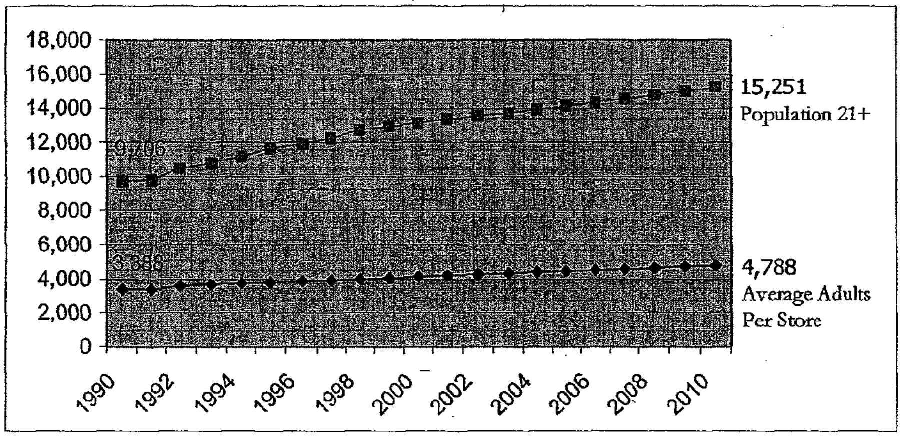
The number of liquor stores peaked in the early 1980s at 180 state-run stores and 188 contract stores. By 2000, the number of state-operated stores decreased to the present 157 stores. The following chart also demonstrates the annual increase in the number of private licensees served by state-run and contract liquor stores.

Population and LCB Store Trends 1940-2001

	1940	1950	1960	1970	1980	1990	2001
Total State Population	1,736,191	2,378,963	2,853,214	3,413,244	4,132,353	4,866,692	5,974,900
State Stores	51	101	101	110	173	171	157
Contract Stores	134	142	160	167	182	176	155
Licensees served by LCB	*data not available*	914	1,080	1,574	2,279	2,673	3,834

While total population growth is not expected to be as rapid, it is projected the number of drinking age adults will reach 4,434,047 by 2010. As the chart on the next page indicates, the average number of adults and licensees served by each store will continue to increase during the next eight years, unless there is an increase in the current number of stores.

Average Adults Served Per Liquor Store
1990 – 2010



The 1999 Deloitte & Touch Retail Business Plan reported that the number of Washington State liquor outlets per 100,000 people was significantly lower than the U.S. average, and lower than the average in most other control states. Population growth continues to put pressure on the LCB's Retail Services, particularly in the higher growth counties.

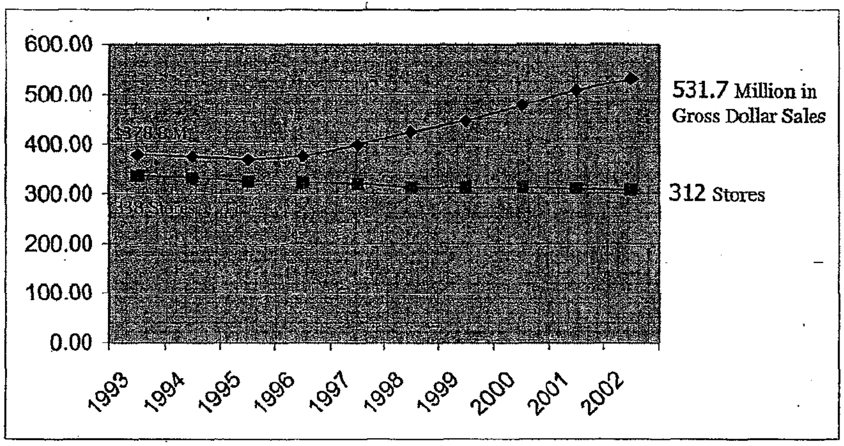
Projected Population Growth--Top Ten Counties in Washington 2000-2015

	2000 Population	2005 Population	% Increase 2000-05	2010 Population	% Increase 2005-10	2015 Population	% Increase 2010-15
Statewide	**5,894,121**	**6,921,808**	**12.33%**	**7,215,892**	**8.98%**	**7,867,806**	**9.03%**
Stevens	40,066	47,158	17.70%	54,039	14.59%	62,522	15.70%
San Juan	14,077	16,521	17.36%	18,987	14.93%	21,578	13.65%
Mason	49,405	58,899	19.22%	66,750	13.33%	75,720	13.44%
Jefferson	26,299	30,195	14.81%	33,793	11.92%	38,197	13.03%
Skagit	102,979	121,451	17.94%	137,054	12.85%	154,785	12.94%
Thurston	207,355	255,703	23.32%	287,919	12.60%	324,690	12.77%
Whatcom	166,814	194,449	16.57%	217,009	11.60%	243,634	12.27%
Cowlitz	92,948	108,369	16.59%	122,416	12.96%	137,286	12.15%
Clark	345,238	413,273	19.71%	465,996	12.76%	520,449	11.69%
Snohomish	606,024	699,238	15.38%	781,806	11.81%	870,116	11.30%

Population growth, particularly in high growth areas such as those listed in the above chart, makes it challenging to effectively penetrate the market and provide adequate customer service during peak buying periods.

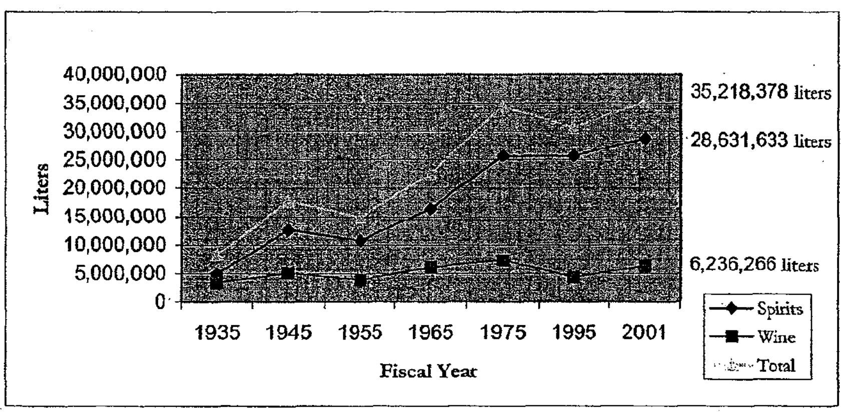
In line with a growing adult population, dollar sales of alcohol are also increasing. The following chart shows the increase in dollar sales in relationship to the number of stores. In looking at this chart, it is apparent that gross dollar sales have grown at a faster rate than retail outlets.

Sales History & Number of Stores



Beginning in 1997, the number of liters sold per FTE increased by 10%. During 1999-2001, the ratio of liter sales per FTE continued at a higher rate than any previous period. It is anticipated this ratio will continue to increase somewhat during the next three years, as additional FTEs per store are not planned. The chart below shows the history of liter sales. There has not been a proportional increase in personnel.

LCB Sale of Alcohol in Liters



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Profits and tax collections increase:

Consistent with sales growth, there has also been growth in the amount of taxes collected and profits generated and distributed to the state general fund, local governments, and health care funds. Between 1992 and 2001, there has been almost a 33% increase in distributions. The chart on the next page shows the taxes and revenue distribution for Fiscal Years 1991 through 2001.

Out of the eighteen states that directly control liquor sales, Washington State ranked third in the percentage of revenue contributed to state and local governments at 41.1% of gross sales in Fiscal Year 2001.[1]

> Out of the eighteen control states, Washington ranked third in the percentage of revenue contributed to state and local governments at 41.1% of gross sales.

[1] *Stateways* magazine, November/December, 2001

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Taxes and Revenue Distribution
10 Year Comparison

REVENUE (Millions of $)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Revenue	64.8	62.1	65.5	61.3	65.3	65.6	77.2	80.7	75.7	79.2
Taxes	90.9	92.3	97.5	95.8	99.4	102.9	107.0	115.8	122.2	127.7
Total	**155.7**	**154.4**	**163.0**	**157.1**	**164.7**	**168.5**	**184.2**	**196.5**	**197.9**	**206.9**

DISTRIBUTION (Millions of $)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Cities	28.8	27.9	27.0	25.7	25.5	26.2	30.3	31.0	29.6	33.0
Counties	7.2	7.0	6.8	6.4	6.4	6.6	7.2	7.4	7.1	8.2
State	103.7	103.3	99.9	96.8	95.9	98.5	100.7	101.7	107.9	113.0
Border Cities & Counties	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.1
DSHS	4.5	4.8	4.7	5.2	5.4	5.4	5.2	5.3	5.3	5.6
Superintendent of Public Instruction	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.2	0.2
Drug Enforcement	10.2	10.1	11.4	9.9	9.7	9.6	10.1	11.8	10.4	10.2
Health Care			11.8	11.6	20.3	20.7	29.2	37.6	35.8	35.3
Universities	0.7	0.7	0.7	0.8	0.8	0.9	0.8	0.9	0.7	0.6
Rapid Transit	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2
Wine Commission	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.5	0.5
Total	**155.7**	**154.4**	**163.0**	**157.1**	**164.7**	**168.5**	**184.2**	**196.5**	**197.9**	**206.9**

Notes:

- Tax and revenue distributions are passed on actual cash available during a specific time period, and therefore often differ from figures shown on income statements.
- Revenues and distributions are effected by the Cost of Goods Sold. For instance, the trend of customers buying-up to premium products means the LCB's costs for products increase.
- The additional tax for health care was established in 1993 at $0.96 per barrel with automatic increases to $2.39 in 1995 and to $4.78 in 1997.

How LCB's performance ranks with others:

Other LCB results favorably compare to the private liquor industry and other private retail operations in a number of categories, as the following chart indicates.

SAME OR BETTER	ACCOMPLISHMENT
✓	Distributions to state and local governments as compared to the eighteen other control states. For the past two years, Washington State has ranked in the top three states.
✓	LCB's net income was 8.7% in FY 2001. Private liquor stores report averages of between 2.1% to 2.8%.[1]
✓	LCB's cost of goods sold was calculated at 71.9% in FY 2001. Larger private liquor stores report averages of 79.5%.[2]
✓	LCB's inventory turns were 9.76 in FY 2000 and 9.55 in FY 2001 compared to industry averages of 6.3 to 7.7 for private liquor stores.[3]
✓	LCB has an order fill rate that matches the industry average of 95%.[4]
✓	LCB average sale per square foot has historically been comparable or exceeded other control states' averages. The current average sale per square foot of over $560 (2001 figure) is high for many retail businesses.[5]

Retail Services management is committed to looking at ways of continuing to improve profitability and create efficiencies while providing quality customer service. The Washington State University Customer Survey that was completed in 1999 showed that this goal is being accomplished, as overall customer satisfaction with state liquor stores ranked high. Specific questions about customer service, product availability, location, convenience, and safety all scored consistently high.

[1] Bizstats.com/liquor.htm
[2] Same
[3] Same
[4] Deloitte & Touche, LLP, *Washington State Liquor Control Board, Retail Business Plan Final Report*, December, 1999
[5] Same

What are the LCB's opportunities?:

Within the context of the changing liquor industry and market trends, the LCB's Retail Services has a number of opportunities to build upon. These include but are not limited to:

- The LCB's new Strategic Plan and Retail Services Business Plan will provide solid direction for the agency's retail operations.

The LCB's new Strategic Plan and Retail Services Business Plan will provide solid direction for the agency's retail operations.

- The LCB has a monopoly on spirit sales in the state.
- The LCB has an experienced and stable workforce.
- The LCB buys the majority of its product as bailment inventory, which means the product is not paid for until it is shipped from the Distribution Center.
- The LCB is in the process of contracting for a new Merchandising Business System (MBS) for state-operated stores. This will dramatically increase the type and availability of data at all levels of the operation. Once functional, the MBS will greatly improve the ability to manage store operations, purchasing, and distribution using best business practices.
- The new LCB management team is focused on making the Retail Services operation a leader in the industry, and to continually evaluate and review opportunities for new improvements. Areas being focused on include:
  - Developing performance standards for stores to maximize the efficient use of resources.
  - Developing purchasing, merchandising, inventory control, and distribution systems based on transaction data.
  - Developing store siting and leasing strategies consistent with best business practices.
  - Hiring people with the skills needed to implement the business plan.
  - Creating the management tools, reporting mechanisms, and accountability to support the new direction for Retail Services as outlined in this plan.
- Washington State's population will continue to grow, although at a somewhat slower rate. This fact, combined with aforementioned demographic trends, will result in a stable, and in some cases or areas increasing, demand for LCB products.

What are the LCB's challenges?:

While the LCB has many opportunities to build on, there are also significant constraints that limit the potential of the Retail Services operations These include but are not limited to the following:

- The current economic environment and state budget challenges are resulting in decisions that will reduce operational hours in retail outlets and potentially result in other decisions that will reduce, rather than maximize, revenue generating opportunities.
- The need to change the culture of the operation to focus on best business practices as management tools and programs outlined in this plan are implemented.
- The LCB has marketing and advertising limitations unlike other businesses.
- The point-of-sale system being used at state-operated stores has very limited transaction data capacity. Information needed cannot be captured in the present system, limiting analysis of the operation. Systems at contract stores are also independent. The new MBS is scheduled to be fully operating by June 2003 at all state-operated stores. Obtaining transaction data from contract outlets for management purchasing and inventory control purchases continues to be an issue.
- The new Distribution Center opened at its Seattle location this spring with a new automated material handling system. The material handling system is functioning and meeting its off-peak season daily shipping demands. Solutions will be implemented to meet shipping demands for the holiday rush and continuing growth demands. The LCB has negotiated with the material handling system contractor and has reached agreement on solutions to increase shipping capacity to the Board's desired level. As of July 2002, initial steps to integrate these solutions into the system are underway, and are to be completed by the end of September 2002. Labor needs associated with operating and maintaining this system due to increasing shipping demands, particularly during the holiday season, are an issue and are being addressed through a decision package request for the 03-05 biennium.
- Currently, the state's appropriated funding process hampers the LCB's retail operation. Resource allocation or re-allocation decisions that the agency would like to make in response to fluctuations in the marketplace currently must be addressed via requests for appropriation changes through the state budget and decision package processes.

The Future:

The LCB's Retail Services is looking forward to continuing to create systems, efficiencies, and programs as a standard bearer in the industry. Specific plans for how this will be accomplished are outlined in the next three chapters of this business plan. This plan will be reviewed and, as appropriate, revised as more information is available or as environmental conditions change.

Washington State Liquor Control Board
Retail Services Business Plan

CHAPTER 3: OPERATIONS

Overview:

The Liquor Control Board (LCB) operates a large, multi-outlet retail and wholesale business and is an important revenue source for its investors, Washington State taxpayers. Annual gross sales exceed one-half billion dollars. During the past two fiscal years, over 40% of the gross sales generated by LCB operations (including income from licensing and enforcement divisions) have been returned to state and local governments to support a variety of different programs. This distribution in revenues and taxes collected comes after all of the agency's administrative and other program expenses have been funded, including the licensing, enforcement, and education functions of the LCB.

During the past two fiscal years, over 40% of the gross sales generated by LCB operations have been returned to state and local governments.

As mentioned in Chapter 1, Washington State is one of eighteen control state systems in the country. All control states operate within what is called the "three-tier" system. The three-tier system requires that all alcohol beverages sold in the state be distributed through a three-tiered supply chain that includes a manufacturer, wholesale distributor, and retailer. The LCB is the sole wholesale distributor of spirits and the sole retailer through its 157 state-operated and 155 contract stores. Restaurants, clubs, and other facilities that serve distilled spirits must purchase their spirits from a LCB state-run or contract store, and must buy wine and beer from a licensed wholesale distributor.

The LCB divisions directly related to the retail operations (Retail Services, Purchasing Services, and the Distribution Center) combined have 675 budgeted FTEs. As stated in Chapter 2, the collective efforts of these divisions produce results that meet or exceed some private industry and other control state system results. There are a number of reasons for this success, including:

- A monopoly on spirit sales
- Seasoned employees that are experts in the industry
- A bailment inventory system that allows the LCB's Distribution Center to hold a large percentage of its inventory and not pay for product until it is shipped out to stores
- The amount of taxes collected on sales
- Good relationships with stakeholders and suppliers

- Centralized distribution system
- Lean staffing at state-operated stores
- Commission formula for contract stores
- The margins and large-scale of the operations

Consistent with the LCB's strategic goals, management continues to look for ways to increase the bottom-line while maintaining quality customer service. As such, in conjunction with the strategic planning process and the development of this business plan, teams were formed to look for opportunities to improve the business' operations in the following areas:

1. Revenue enhancement opportunities and best practices in retail operations by identifying sales growth opportunities, expense savings opportunities, or some combination of both for retail operations.

2. Revenue enhancement opportunities and best practices in wholesale operations by identifying sales growth opportunities, expense savings opportunities, or some combination of both for wholesale operations.

3. Distribution and purchasing, with particular emphasis on how to favorably impact the Cost of Goods Sold.

4. Customer service and store presentation, with particular emphasis on in-store merchandising and design strategies.

5. Management tools and technology, with employees identifying management systems, reporting, quality control, or corrective action tools for system improvements.

This business plan incorporates the best ideas and opportunities developed through the collective efforts of LCB staff, stakeholders, and other experts in the industry.

Retail Operations:

Within the context of preventing the misuse of alcohol and tobacco through enforcement, education, and controlled distribution, a goal is to maximize revenues via the retail operations. Enhancing the bottom line in retail sales while maintaining high customer service requires a focus on basic best business practices whenever possible. This is a change of orientation, since bottom line considerations have not been the historical focus. Basic information needed to make many decisions and evaluate the profitability of individual stores has not been available, nor in some cases has management had the specific retailing skills to implement best practice approaches. In addition, working within the context of appropriated funding restricts management's ability to respond to market changes quickly and invest or re-invest resources as needed to optimize profitability.

During this past year, a new management team has come on board and is looking at the bottom-line. While the operations have performed well in many ways in spite of the aforementioned challenges, management is committed to doing better.

The short-term opportunity is to focus on training and refocusing of store staff and managers on performance and bottom-line considerations while the new Merchandising Business System (MBS) is being installed. Once installed, the MBS will provide transaction data at the store level for state-operated stores. This will be a tremendous tool in being able to manage by the numbers.

The intended refocusing is already starting to occur. As a result of the collective efforts of many people at all levels of Retail Services, a number of opportunities for enhancing profitability have been identified. Initiatives considered essential to operations are presented in this chapter. Many other opportunities were brought forward and are still on the table for future implementation or further research and evaluation. Some of these opportunities can be implemented now (this upcoming fiscal year), while others are planned for the upcoming biennium and beyond.

1. **Relocate the least profitable stores**: There are many variables to consider in making decisions on store relocations. There are also many variables that effect what the net impact such decisions have on total sales and aggregate profitability of the total operations. The following steps will be taken in making these decisions:
   - Establish performance standards for state-operated and contract stores.
   - Once standards are established, review all stores against these standards.
   - Develop a list of the least profitable stores and prioritize the ones that are achieving the least return, and make determinations as to what to do next (e.g., corrective action, training, relocation, etc.).

   While the establishment of standards is in the process, an example of possible standards for state-operated stores follows:

   - <u>Revenue return ratio</u>: The opportunities for stores to generate revenue for state and local governments is via tax collections on sales and net income. A formula that takes into consideration both taxes and net income or net losses is:

     $$\frac{\text{Taxes collected plus net profit or minus losses}}{\text{Sales for reporting period}} \quad \textit{(divided by)}$$

     The resulting ratio is an indicator of how much return a store is generating. A 25% return is suggested as a minimum threshold, with some consideration given to a store that has disproportionate wholesale sales volume.

Second tier criteria to be used for those stores that demonstrate a minimum 25% return could be as follows:

- <u>Average sales per square foot</u>: A minimum for review would be $350 of sales per square foot. A next step would be to determine what could be done to increase this sales rate to at least $400 per square foot via training or corrective action.

- <u>Sales to FTE ratio</u>: A minimum for review would be the average store FTE count divided by the average sale. If this minimum is not met, determine what could be done to increase sales per FTE via training or corrective action.

- <u>Proximity to other state-operated or contract outlets and net revenue impact</u>: Determine if any other stores are within a five to ten mile radius of the store under review, with consideration given to whether it is in an urban or rural location and accessibility to licensee accounts. Assuming stores within five to ten miles of a closed store will absorb a portion of the closed store's business, estimate the net revenue loss of the closure.

The preceding samples of performance standards assess the net return to state and local governments and consider other performance factors in making a relocation decision.

If relocation is a consideration, projections would be required to determine a break-even sales point and assess the feasibility of breaking even within a two-year period, particularly if any fixed expenses might change, such as rent. The strategy for relocations is to identify high-traffic locations that have similar customer demographics that would result in higher sales and revenue return. An example would be moving into existing locations next to grocery stores, or a mall where a grocery store is an anchor tenant.

The goal in this process is to make thoughtful decisions regarding what action(s) are most appropriate to take of all the stores in aggregate, with the end goal to maximize revenues and improve customer satisfaction.

2. **Open additional retail stores:** The market trend data presented in Chapter 1 indicates there are opportunities to selectively expand via the opening of new stores, particularly in the state's highest growth areas. As the data indicates, fewer stores are serving more people per capita than ever before. In some cases, stores' capacity is very stretched, particularly during peak buying periods. These indicators, coupled with the fact there are particular growth niches, point to the opportunity to add a limited number of new stores during the next biennium. The goal is to open five new stores during the next biennium.

   Projections and assumptions for a one new store and a four new store scenario are presented in the Financial Plan section. The investment is projected at $450,000 per store for the biennium. The projected return on this investment over two years (including profits and taxes collected) is $1,637,290. For five stores, given the assumptions made, the investment is $2,250,000 for the biennium with a return of $4,226,480.

   There is also an opportunity to experiment with pilot store concepts, such as a hybrid contract store (a contract store with a negotiated commission structure and operational standards). Currently state contract stores do not have performance standards built into their contract. As with state-operated stores, a next step in evolving to best business practices is to establish performance expectations.

3. **Develop a store siting and leasing strategy:** As occupancy costs become a bigger expense factor and as the operation focuses on maximizing revenues and efficiencies, the siting or relocation of stores is an important consideration. As mentioned previously, it is important that stores being considered for relocation are weighed against agreed-upon performance standards. It is also essential to have standards for new store opportunities. In addition, having criteria for evaluating lease opportunities and maximizing location decisions is extremely important. Options with respect to leasing strategy are currently under review. One option being considered is having the Department of General Administration perform leasing services.

4. **Sell liquor-related accessories in the state-operated stores:** This is an opportunity to better serve customers and generate additional revenue. Merchandise that relates to liquor sales, such as mixers, corkscrews, bottle bags, bar books, gift cards, swizzle sticks, shakers, wine stoppers, etc., are all items that would be convenient for customers to buy along with their liquor purchases. This type of merchandise also has larger profit margins and requires limited space for merchandising. If

   > A conservative estimate of sales potential for selling liquor-related accessories is $2,000,000 over a two-year period.

Resp to Costco RFP
1855

TX175_028

there is agreement to move forward with this opportunity (a RCW change is needed), a first step in implementing this strategy would be to conduct a customer survey to determine the best product mix, and to consult with stakeholders. A conservative estimate of sales potential for selling liquor-related accessories is $2,000,000 over a two-year period.

5. **Acquire and strategically place plastic hand shopping baskets at state-operated stores:** This is a small investment with good return potential. Retailing research indicates shopping baskets can increase sales, particularly impulse purchases. Providing customers with a method for adequately carrying multiple items, particularly with the size and breakage potential of liquor bottles, is a worthwhile investment. While stores do have baskets now, they are too small, too old, or too few to be worthwhile or noticed, and are often not strategically located. The combined projected tax collections and impact on net income over two years is $1,351,958 with an investment of $15,700 for 157 state stores.

6. **Evaluate and possibly expand the store personnel customer service training program:** The LCB currently has an established training program for store personnel that includes customer service training. However, since exceptional customer service is an important performance goal of the operation, the LCB will be evaluating an expanded, multi-tiered customer service training program, such as the model currently used by the Pennsylvania Liquor Control Commission. The Pennsylvania model is much more extensive and is reported to have excellent results. Investigation of this and other programs will be done to determine the best program options consistent with resources availability.

Wholesale operations:

Sales to licensees (restaurants and other establishments that re-sell distilled spirits) represent approximately 20% of total sales. Licensees are served by all 312 stores. In addition, there is one store in Seattle that only sells to wholesale customers. As with other areas of the operation, opportunities to improve customer service as well as maximize profitability and return continue to be reviewed and researched. Opportunities on the table at this time are as follows:

1. **Create a web-based ordering system for licensees:** Enable web orders with individual sign-on for licensees. After a licensee completes an order, it would be e-mailed to their assigned pick-up location for processing. This would save time for licensees as well as allow store staff to better manage their time.

2. **Support the establishment of a delivery program:** Deliver product to wholesale customers in urban areas. It is felt it would be cost-prohibitive for the LCB to operate this service. However, if demand warrants, the LCB will help promote outsourcing this to a private delivery service or services.

<u>Purchasing and Merchandising:</u>

As the Deloitte & Touche Retail Business Plan emphasized, leading retailers generally use a merchandising strategy which sets the course for product selection, ordering, product allocation to stores, store layout, and shelf and category management. The LCB has policies and systems for product selection, purchasing, and distribution. However, there is not an overall merchandising strategy currently in place, nor shelf or category merchandising programs. In addition, the Purchasing Division is currently using an aged forecasting and reorder system that does not operate on modern inventory management principals.

With the implementation of the MBS in June 2003, transaction data from state-operated stores will be available. However, to function in the more sophisticated environment of changing niche markets that are described in Chapter 2, more focus in this area is needed.

Successful merchandising programs can generate sales and maximize margins, particularly in a changing marketplace. Input from manufacturers suggests an effective store merchandising program can increase sales between two and three percent, although the specific success rate is difficult to prove as there are many variables that impact sales trends. If only a 1% increase were realized, the LCB's annual sales would increase by over $5,000,000. This opportunity is supported by research that indicates the majority (66%) of consumer decision making occurs in the store and that today's customers make choices quickly after minimal search and price comparison. A store-merchandising program can:

> Successful merchandising programs can generate sales and maximize margins, particularly in a changing marketplace. If only a 1% increase were realized, the LCB's annual sales would increase by over $5,000,000

- Promote ease of product selection
- Encourage impulse purchases
- Optimize shopper trade-ups
- Help minimize out-of-stocks
- Make product mix decisions and inventory control easier

Initiatives in this area include:

1. **Create a merchandising program at the store level:** Basic elements of a merchandising program would include, but not be limited to, the following:

   - Optimum product selection
   - Uniformity of look in state-operated stores
   - Effective category and shelf management programs
   - Consistency with current design concepts
   - Expanded training for store managers
   - Maximum use of floor and shelf space
   - Consistent and effective signage
   - Flexibility in fixturing

   There is also a need to work with contract stores to implement merchandising strategies on a store-by-store basis.

   A key component of this initiative is to create a Merchandising Manager position to focus work in the above areas in an unbiased way that is supported, but not reliant on, suppliers. This opportunity is similar to when a Wine Program Manager position was created in 1996 to specifically focus on the purchasing and merchandising of wine. Since this position was created, wine sales rose from $19 million in 1996 to over $36 million in 2001. The result of this focused effort has been impressive growth. There is a similar need for focusing on the merchandising of other products in tandem with the wine program.

2. **Acquire shelf management software for liquor store operations:** In combination with the establishment of a Merchandising Manager position, shelf management is needed. Proper shelf management, based on an impartial review of sales history and category trends, can lead to increased profits by encouraging consumer purchases of higher priced, higher profit items. The liquor industry is one of the few businesses that has shelf merchandising software particular to the industry. This software incorporates a large amount of research on buying patterns and strategies for maximizing sales.

3. **Develop a category management program:** A category management program would optimize product selections and mix, and should take into account the LCB's unique position in the marketplace with respect to selling and availability of spirits and customer service goals. Input from customers

as well as store personnel is needed to determine the best approach to managing product mix.

4. **Reduce Costs of Good Sold:** In addition to establishing a merchandising program, a number of other opportunities are being considered to either increase sales or reduce the Cost of Goods Sold. While reviewing ways to control purchasing costs is ongoing, a goal has been established to reduce Cost of Goods Sold by 1% during the next biennium, from 71.5% to 70.5% of gross sales. Examples of steps planned to support this goal include:

   - Increasing the number of times distilled spirits suppliers are allowed to offer costs reductions from five times a year to six times a year
   - Work with suppliers to develop a discount program for net ten-day payment terms
   - Review opportunities to increase bailment inventory
   - A just-in-time ordering system, using MBS and purchasing software previously mentioned
   - Increased distribution efficiencies

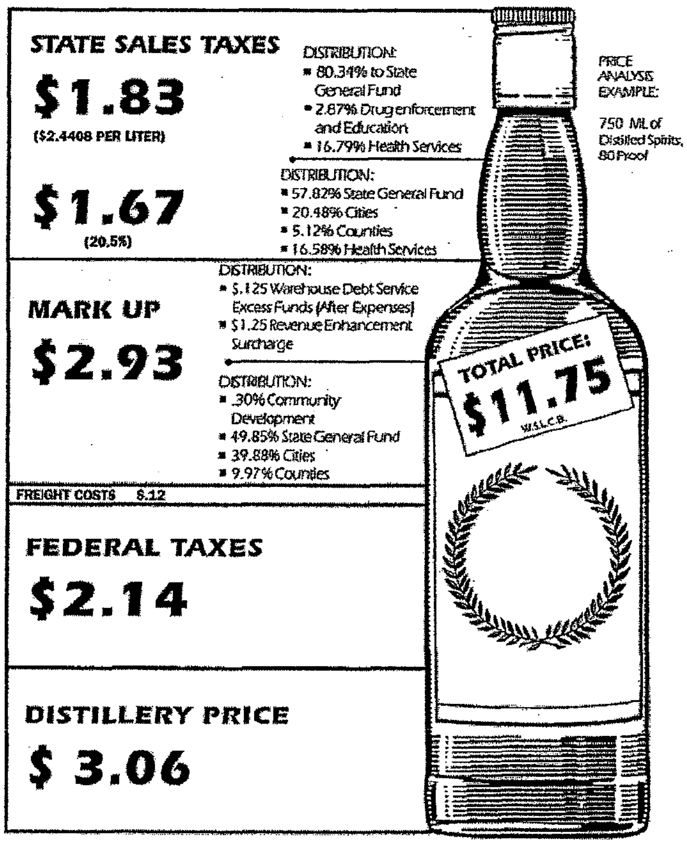
Pricing:

The retail price of liquor sold in state-run and contract liquor stores is determined by five elements:

1. Distiller's, brewer's, or vintner's price to the Board
2. Federal taxes--excise tax rates on all liquor, plus custom duty rates on imported liquor
3. Freight costs
4. Markup which is controlled by the Board
5. State sales taxes that are set by the State Legislature

On the following page is a breakdown of how the above elements are applied to the pricing of one bottle of liquor.

WHERE YOUR LIQUOR DOLLARS GO . . .



FEDERAL AND STATE TAXES AMOUNT TO $ 5.64 OR 48.00 PERCENT OF THE $11.75 TOTAL PRICE.

For wholesale accounts, a standard discount is given. Discount rates and tax exemptions are also established for Tribes and military establishments.

For spirits, the Board approves all new product listings, and these products have twelve months to meet profitability requirements. Spirit listings are recommended to the Board by the Purchasing Services Director, using established criteria. Wine listings are recommended to the Board by the Wine Program Manager, with input from the Wine Advisory Committee. Wines are available for general distribution to all stores or are distributed to "hub stores," who receive wines that are bought in smaller quantities and act as a regional hub for other stores in the area that may wish to sell these products. Existing products are reviewed annually to see if they meet the profitability standard for their product class.

The markup the Board establishes on products, and the resulting margins made on sales, is the key determinant of the Cost of Goods Sold percentage. In conjunction with the goal of reducing the businesses Cost of Goods Sold, a review is being done to determine opportunities to increase margins on specific products to support the Cost of Goods Sold reduction goal.

Inventory management:

Inventory management is a key component of purchasing and merchandising. Knowing where stock is, what is in stock and out-of-stock, setting inventory levels, and managing inventory turns and special order programs all affect purchasing and merchandising decisions. The Point of Sale system provided by the MBS will result in having new data available from state-operated stores and the Distribution Center. This will be a dramatic improvement in managing inventory levels.

During the next three years, managing inventory levels will be a third way of reducing the business's Cost of Goods Sold. Results of this effort will include the following:

1. **Reduce current inventory levels at the store level by June 30, 2003:** Inventory levels at stores have increased during the past several years as the result of a number of factors. Inconsistent or less frequent deliveries of product during the time the new Distribution Center was being built resulted in stores stockpiling inventory to ensure they did not run out. The new Distribution Center is now open and meeting its off-peak season daily shipping demands, which will eliminate the need for the stores to stockpile. While this inventory reduction will not result in any appreciable change to the LCB's long-term Cost of Goods Sold, it will have a small impact on the Costs of Good Sold percentage during the time when inventory levels are being reduced.

2. **Revamp the special order program** to significantly reduce the number of special order items that are sitting on store shelves and not achieving acceptable inventory turns. A number of suggestions have been made on how best to refresh the special order program while improving customer service. These suggestions will be evaluated and policies or distribution strategies modified as needed. Training at the store manager level is also needed to implement whatever strategy(ies) are chosen.

3. **Increase inventory turns in state liquor stores:** The goal is to increase inventory turns from the current 9.55 turns per year to 10 inventory turns per year by June 30, 2004, and to 10.5 inventory turns by June 30, 2005. Achieving more inventory turns will result in improved profitability for the business, and will produce sales and/or reduce the Cost of Goods Sold.

4. **Charge a flat rate restocking fee of $25 for licensee returns:** This fee would only apply to changes in liquor selection, not ordering or shipping mistakes. It is not expected this would generate much revenue, but would help recoup restocking costs at the Distribution Center or result in fewer returns. Charging a restocking fee is a standard in the retail industry.

Good data is needed to achieve the efficiencies and results sought in the areas of inventory management, purchasing, and merchandising. The MBS is scheduled to be functioning by June 30, 2003. As previously mentioned, this will be a tremendous improvement. However, only half the stores (the state-operated stores) will be on this system. To be able to function effectively on a system-wide basis, the 155 contract stores need to be part of the MBS as well.

Distribution:

The mission of the LCB's liquor Distribution Center is to ensure the timely, safe, and efficient receipt, storage, and shipment of spirits, wine, and beer to the 312 state-run and contract liquor stores and to tribal and military outlets located throughout the state.

As part of the agency's plan to modernize the state's liquor retail and distribution systems, the LCB's original Distribution Center was replaced with a new 160,000 square-foot facility on the existing Seattle site. The LCB has been operating out of the new Distribution Center as of April, 2002 with a new automated material handling system to process the approximately 17,000 cases of liquor shipped out of the facility each day.

The material handling system is functioning and meeting its off-peak season daily shipping demands. The LCB negotiated with the material handling system contractor and have agreed upon solutions to increase shipping capacity to the Board's desired levels. As of July 2002, initial steps to integrate the solutions into the system were underway and will be complete by the end of September 2002, in time for the holiday rush.

The Distribution Center maintains a daily inventory level of between 400,000 and 500,000 cases of liquor, depending on peak periods. The receiving department processes receipts from approximately 330 domestic and international shippers. Local freight carriers transport product weekly to the 312 retail outlets. In 2001, shipments increased from 3,752,318 to 3,825,320 cases.

Daily shipments increased 1.9% over the previous year, with weekly totals of approximately 77,443 cases. The October through December, 2001 holiday period saw daily receipts and shipments as high as 45,000 cases.

Having a reliable and responsive distribution system is essential to the success of the overall operation. As such, the following strategies have been established to support this goal:

1. **Level out the Distribution Center's shipping volume over the course of a week:** The Distribution Center has historically experienced substantial peaks and valleys in shipping volumes over the course of a week. The intent is to work with shippers to even out delivery schedules over the course of a week so there is more surety for shippers and less waiting around time, and more surety for the stores.

2. **Consistently achieve a delivery fill rate of 95% of available product:** In order to accomplish this goal, the staffing at the Distribution Center needs to be modified and spare parts inventory acquired. In March 2002, the Pinnacle Consulting Group completed an analysis of the FTE labor requirements to manage, operate, and maintain the Distribution Center. Projections show the Distribution Center needs 64 FTEs to achieve a throughput of 17,000 cases in an 8-hour shift. In addition, projections indicate a second shift will be necessary from September through December to meet daily output requirements during the peak holiday season.

   It is also important that the Distribution Center has spare parts readily available as existing parts break or wear out. Any downtime affects deliveries and availability of stock at stores. Because the vendor is from overseas, some parts are not readily accessible. The plan is to obtain an inventory of small parts from the vendor to be physically located at the Distribution Center.

3. **Complete inventory cycle counts at the Distribution Center without stopping deliveries:** In the past, the Distribution Center has shut down for two to three days in order to do a wall-to-wall inventory count on paper and transfer the information to the inventory system. This process impacts delivery schedules and product availability. A method is being developed to conduct year-around cycle counts with real-time inventory accuracy. These cycle counts will give purchasing, retail, vendors, and the Distribution Center a real-time snapshot of current inventories, instead of a one or two times a year inventory. This will speed up discrepancy reconciliations and provide a higher rate of inventory accuracy.

CHAPTER 4: MANAGEMENT

The Management Team:

There is a new management team at the Liquor Control Board (LCB). During 2002, new persons have come on board in the following positions:

- Administrative Director
- Financial Services Division Director
- Retail Services Division Director
- Information Technology Services Division Director
- Licensing and Regulation Division Director
- Policy, Legislative, and Media Relations Division Director

The Board, along with its new management team, is setting a new course. This restructured organization underscores the Board's commitment to greater operational effectiveness with increased efficiencies. The management team remains committed to preventing the misuse of alcohol and tobacco through education, enforcement, and controlled distribution. Within this context, this management team is also committed to maximizing revenues to the state's taxpayers by operating a dynamic and efficient retail and wholesale liquor business.

The new Retail Services Director has over 25 years of successful retail experience in bottom-line results, troubleshooting, and personnel management with the emphasis on team building. He has been instrumental in setting the new course for Retail Services.

Management tools:

To support the new course for Retail Services, a culture change is occurring--one that uses management tools that have not been available or used at the store level where business actually occurs.

1. **Goal setting at the store level:** Winners keep score! Part of the new management direction is to establish measurable standards in stores and to budget at the store level. This will be a large factor in supporting the culture change to a business-oriented perspective. Long-term, the MBS is essential in making this happen. Short-term (during this next fiscal year), the process will start by:

   - Making adjustments to the Agency Financial Reporting System (AFRS) to allow for an accurate breakdown of expenses by store.

- With this adjustment, producing income statements by store. Month-end statements will show the bottom line profitability of the stores.
- Once this capacity is achieved, establishing monthly or daily goals. Prior to the implementation of MBS, the LCB will develop a simple tracking sheet for all store employees to see and monitor progress against.

Training on how to set goals and motivate by tracking this information will be a focus during this next fiscal year in anticipation of having even more capacity once the MBS is implemented.

2. **Merchandising Business System:** As previously mentioned, the implementation of the Merchandising Business System (MBS) will have a major impact on the operation's ability to manage by the numbers and implement best business practices. The MBS package will enable the LCB to link key business components together into a single, functionally sound retail supply system that provides common business components found throughout today's retail industry. It will also transition the LCB from an inventory-based system to a transaction-based business model. Key functions that will be integrated include:

The MBS package will enable the LCB to link key business components together into a single, functionally sound retail supply system.

- Retail sales: Processing special orders, point-of-sale, returns, scanning, credit/debit card processing
- Merchandising: Purchasing, inventory control, product replenishment, product forecasting
- Financial: Accounts payable and receivable, internal audits, tax payments
- Distribution Center: Interfacing with the MBS regarding receiving, shipping, transfers, physical inventory, special orders

The benefits anticipated from this investment include:

- Increased system reliability and a more complete, accurate, and timely picture of the LCB's retail business
- More efficient purchase order management
- Greater accuracy in product inventories
- Improved customer service at the point of sale
- Enhanced productivity

The MBS is targeted to be fully functional and ready to deploy at the state-operated stores by June 30, 2003. During this next fiscal year, MBS set up and training will be a primary focus of management.

Also, as mentioned previously, there is a need to integrate the 155 contract liquor stores into the MBS so it will be functional system-wide. Until this occurs, two separate data collection processes will be in place. The contract liquor stores currently operate under independent point-of-sale systems and report only at pre-defined intervals. In 2001, contract stores outlets accounted for 13.1% of total gross sales. The transactions associated with this revenue need to be part of the MBS in order to provide a true and accurate picture of sales, inventory, distribution, and profit margins.

3. **One overall financial data tracking system:** The Agency Financial Reporting System (AFRS), the Comprehensive Agency Financial Reporting System (CAFRS), and internal reports all have differences, including reporting timeframes and particular expense codes. This is not atypical. However, the goal is to have one overall financial data tracking system that will be able to respond to different reporting needs. Implementation of the MBS is a large part of accomplishing this objective. The MBS is a general ledger-driven system. In order to upload into current state systems, a crosswalk from the MBS general ledger to the state AFRS is needed. This will take some time to accomplish but is doable. The goal is to have this done by the end of fiscal year 2005.

4. **Enhanced telecommunications network infrastructure:** Currently stores communicate with host systems through a dial-up connection. The connection speeds are slow and data transmission is not secure or reliable. Retail Services is unable to take advantage of advancements in security, software versions, and e-business solutions due to the limitations of these dial-up connections. On-site visits are often necessary for any needed software or configuration enhancements.

   Once point-of-sale systems are installed during Fiscal Year 2003, it will become even more important to have "always-on" capability. An upgrade to the network infrastructure would have the following benefits:

   - Retail employees will be able to use changing business processes such as electronic commerce and support systems, and will have the speed, reliability, and tools they need to conduct business in a timely and efficient manner
   - Increased accountability and security of network
   - Improvements in customer service such as faster credit card transactions and real-time inventory and product availability assessment

- Electronic reporting systems, e-mail services, and Intranet and Extranet resources can conveniently be used with an always-on connection

5. **Customer Feedback:** Customer comments are an important management tool. Stores currently have cards for customers to fill out if they have comments. These cards are sent to the Retail Services administration and are compiled and reviewed. Copies are also sent to the Board Members. Follow-up on comments is done as appropriate.

   The LCB is currently working on improving how it tracks and responds to customer comments by doing the following:

   - Creating a new format for customer comment cards, and having the cards addressed directly to the Board Members
   - Creating a central point of contact for customer contacts
   - Creating a database to track and categorize comments
   - Reviewing the potential for online customer comment cards
   - Considering doing an annual customer survey

   While an annual survey is important in order to give the most complete and unbiased feedback, it takes resources to do. The customer survey completed by Washington State University in 1999 cost approximately $70,000. Given the limitations of resources, other survey options will be reviewed.

6. **Reward employees for performance:** Successful retail operations have employee performance incentive programs. This, coupled with goal setting, is one of the most significant factors in changing an operation's culture. Exploring a performance-based employee reward program is part of the long-term plan of implementing best business practices.

CHAPTER 5: FINANCIAL PLAN

The Financial Division of the LCB provides forecasting, budgeting, and administrative support to Retail Services as it does to all other divisions of the agency. As such, a financial forecast was presented to the Washington State Forecast Council in June 2002 that provides estimates of revenue and expenses (with assumptions) through 2005 for Fund 335 and Fund 501. Fund 335 was established to pay for and pay off the construction of the new Distribution Center. Fund 501 accounts for all the revenue and expenses of the LCB operations, although the majority of both revenue and expenses are associated with Retail Services operations.

Projections:

Through this business planning process, opportunities have been identified for increasing revenue as well as decreasing expenses that were not incorporated into the June 2002 forecast. An overview of assumptions associated with these opportunities is presented in the chart beginning on the next page. If all these opportunities are pursued, a total projected investment of $3,429,082 will be needed. It is projected this investment would result in the following returns through Fiscal Years 03-05:

Projected sales increases: $29,208,000

Projected revenue impact (net income and taxes collected): $17,210,575

In addition, financial projections, with assumptions, have been prepared for new store opportunities. As indicated in Chapter 3, for one new 4,965 square foot store a projected biennial investment of $450,000 is needed. The projected return on this investment over two years (including net income and taxes collected) is $1,637,280. The projected return on this investment over two years (including profits and taxes collected) is $1,637,290. For five stores, given the assumptions made, the investment is $2,250,000 for the biennium with a return of $4,226,48. (These investments and return figures are included in the above totals).

Non-appropriated funding:

As mentioned in Chapter 1, a major constraint of Retail Services' ability to operate most efficiently and consistent with the LCB's mission and goals is the fact that it operates under the traditional appropriated state-funding model. While this model works well for many critical functions of state agency operations, it does not work well in the retail environment, which requires the ability to respond quickly to a variety of market forces.

The inability to respond to market trends via the expansion or contraction of stores or the reallocation of resources in the changing retail and the liquor environments limits the profitability of the retail operations. Currently, changes require requesting appropriation changes through the current budget process, which is complex and time-consuming. A more workable alternative is to change to a non-appropriated funding model. With this status, the LCB would establish a reserve level that would allow it to respond within approved parameters to the marketplace, without waiting on supplemental budget requests or the decision package process. Having the ability to manage and respond within the realities of the retail environment is a needed step in maximizing revenues to the state's taxpayers. This alternative would allow more flexibility in reinvesting in the business which can increase sales, improve customer service, and decrease costs.

Following is a list of opportunities that have been identified to increase revenue, decrease expenses, and increase customer service.

Revenue generators:

	OPPORTUNITY	TIME PERIOD	PROJECTED SALES INCREASE	PROJECTED ADDITIONAL TAXES AND NET INCOME	INVESTMENT ($ and FTEs)	RCW, WAC, AND/OR DECISION PACKAGE REQUIRED?	HOW OPPORTUNITY FITS INTO LCB STRATEGIC PLAN
1.	**Create a merchandising program** (see Chapter 3, page 8) **Acquire shelf management software** **Develop a category management program**	03 to 05	$5,000,000 for biennium	$1,525,000 for biennium (net income estimated at 5% of sales increase)	Total investment of $226,500 for biennium ($105,000 is a one-time expense), 1 FTE: ▪ Salary at $50,000, ongoing ▪ Equipment & travel at $12,500, partially ongoing ▪ Store fixturing at $78,500, one-time ▪ Software at $25,000, one-time	No	Addresses Goal 3 of Strategic Plan, "Maximize revenues to the state's taxpayers" Strategy: "Optimize retail outlet resources to serve the public" Solution: Subparagraph 1, "Develop and implement shelf management schematics"
2.	**Sell products that compliment liquor (mixers, corkscrews, gift bags, etc.)** (see Chapter 3, page 5)	04 to 05	$2,000,000 for biennium	$660,000 estimated minimum for biennium (additional tax is sales tax)	Initial investment estimated at $392,500 for all stores, customer survey needed	Would require an RCW change, then initiate a pilot program	Addresses Goal 3 of Strategic Plan, "Maximize revenues to the state's taxpayers" Strategy: "Optimize retail outlet resources to serve the public" Solution: Subparagraph 5, "Implement store efficiencies"

Revenue generators--continued:

	OPPORTUNITY	TIME PERIOD	PROJECTED SALES INCREASE	PROJECTED ADDITIONAL TAXES AND NET INCOME	INVESTMENT ($ and FTEs)	RCW, WAC, AND/OR DECISION PACKAGE REQUIRED?	HOW OPPORTUNITY FITS INTO LCB STRATEGIC PLAN
3.	**Acquire/strategically place plastic shopping baskets** (see Chapter 3, page 6)	NOW	$2,900,000 for biennium	$1,351,958 for biennium	$15,700 from existing resources, one-time investment to replace old baskets	No	Addresses Goal 3 of Strategic Plan, "Maximize revenues to the state's taxpayers" Strategy: "Optimize retail outlet resources to serve the public" Solution: Subparagraph 5, "Implement store efficiencies"
4.	**Improve the special order process** (see chapter 3, page 11)	03 to 05	$1,200,000 for biennium, one-time savings (estimated at 2% of sales, will reduce inventory)	$586,620 for biennium, one-time increase (net income estimated at 5% of sales)	None	Will require a WAC change to reflect process changes	Addresses Goal 3 of Strategic Plan, "Maximize revenues to the state's taxpayers" Strategy: "Optimize retail outlet resources to serve the public" Subparagraph 3, "Reduce costs of carrying special order inventory"
5.	**Open new retail stores** (see Chapter 3, page 5)						
	One store option	03 to 05	$3,608,000 estimated for biennium (for a 4,965 sq. ft. store)	$1,637,280 estimated for biennium	$450,000 estimated for biennium, 3.5 FTEs each year	Would require a decision package	Addresses Goal 3 of Strategic Plan, "Maximize revenues to the state's taxpayers" Strategy: "Optimize retail outlet resources to serve the public" Solution: Subparagraph 4, "Optimize the potential revenue sources through store location"
	Four store option	03 to 05	$9,000,000 (estimated for biennium (for a 4,965 sq. ft. store)	$4,093,200 estimated for biennium	$1,800,000 estimated for biennium, 14 FTEs each year	Would require a decision package	
	"Hybrid" contract store pilot (contract stores with performance standards in contract)	03 to 05	Under review	Under review	Under review	Under review	

Revenue generators--continued:

	OPPORTUNITY	TIME PERIOD	PROJECTED SALES INCREASE	PROJECTED ADDITIONAL TAXES AND NET INCOME	INVESTMENT ($ and FTEs)	RCW, WAC, AND/OR DECISION PACKAGE REQUIRED?	HOW OPPORTUNITY FITS INTO LCB STRATEGIC PLAN
6.	**Relocate least profitable stores** (see Chapter 3, pages 3-4)	03 to 05	$5,500,000 for biennium, projected increase over current sales	$2,956,517 for biennium, projected increase over current revenues	$369,382 for biennium to relocate 13 stores	Would require a decision package	Addresses Goal 3 of Strategic Plan, "Maximize revenues to the state's taxpayers" Strategy: "Optimize retail outlet resources to serve the public" Solution: Subparagraph 4, "Optimize the potential revenue sources through store location"
7.	**Charge a flat rate restocking fee for licensee returns** (see Chapter 3, page 12)	03 to 05	Small impact, will recoup restocking costs	Small impact, will recoup restocking costs	Existing resources	Possibly a new RCW or WAC, researching	Addresses Goal 3 of Strategic Plan, "Maximize revenues to the state's taxpayers" Strategy: "Optimize retail outlet resources to serve the public" Solution: Subparagraph 5, "Implement store efficiencies"
8.	**Setting goals at the store level** (see Chapter 4, pages 1-2)	NOW	Future increases to be determined (ability to manage within budget)	Future increases to be determined (ability to manage within budget)	Existing resources, a policy & training effort	No	Addresses Goal 3 of Strategic Plan, "Maximize revenues to the state's taxpayers" Strategy: "Optimize retail outlet resources to serve the public" Solution: Subparagraph 2, "Implement management tools to minimize expenses"

Distribution efficiencies:

	OPPORTUNITY	TIME PERIOD	PROJECTED SALES INCREASE	PROJECTED ADDITIONAL TAXES AND NET INCOME	INVESTMENT ($ and FTEs)	RCW, WAC, AND/OR DECISION PACKAGE REQUIRED?	HOW OPPORTUNITY FITS INTO LCB STRATEGIC PLAN
9.	**Reduce Costs of Goods Sold from 71.5% to 70.5% by June 30, 2005** (see Chapter 3 page 9)	03 to 05	Refer to impact on net income	$2,400,000+ for biennium minimum (efficiencies at Distribution Center & Purchasing)	None, within existing resources	No	Addresses Goal 3 of Strategic Plan, "Maximize revenues to the state's taxpayers" Strategy: "Optimize retail outlet resources to serve the public" Solution: Subparagraph 6, "Implement improved inventory management and reduce out of stocks"
10.	**Increase store inventory turns** from current 9.55 turns per year to 10 turns by June 30, 2004, and to 10.5 turns by June 30, 2005 (see Chapter 3, page 12)	03 to 05	Refer to impact on net income	$2,000,000 for biennium minimum (margins will increase, estimate based on 01-02 figures)	None, within existing resources	No	Addresses Goal 3 of Strategic Plan, "Maximize revenues to the state's taxpayers" Strategy: "Optimize retail outlet resources to serve the public" Solution: Subparagraph 6, "Implement improved inventory management and reduce out of stocks"
11.	**Level distribution center's shipping volume out over a week** (see Chapter 3, page 13)	NOW	Enhanced customer service	Effect outlined in opportunities 10 and 11	None, use existing resources	No	Addresses Goal 3 of Strategic Plan, "Maximize revenues to the state's taxpayers" Strategy: "Optimize retail outlet resources to serve the public" Solution: Subparagraph 8, "Implement level shipping schedules to equalize volume"

Distribution efficiencies--continued:

	OPPORTUNITY	TIME PERIOD	PROJECTED SALES INCREASE	PROJECTED ADDITIONAL TAXES AND NET INCOME	INVESTMENT ($ and FTEs)	RCW, WAC, AND/OR DECISION PACKAGE REQUIRED?	HOW OPPORTUNITY FITS INTO LCB STRATEGIC PLAN
12.	**Distribution Center to consistently achieve a 95% fill rate of available product** (see Chapter 3, page 13)	NOW	Enhanced customer service	Effect outlined in opportunities 10 and 11	None, use existing resources	No	Addresses Goal 3 of Strategic Plan, "Maximize revenues to the state's taxpayers" Strategy: "Optimize retail outlet resources to serve the public Solution: Subparagraph 9, "Implement Improvements to the Material Handling System at the Distribution Center"
13.	**Complete inventory cycle counts at the distribution center without stopping deliveries** (see Chapter 3, page 13)	NOW	Enhanced customer service	Effect outlined in opportunities 10 and 11	Existing resources	No	Addresses Goal 3 of Strategic Plan, "Maximize revenues to the state's taxpayers" Strategy: "Optimize retail outlet resources to serve the public" Solution: Subparagraph 7, "Implement cycle county inventory method"
14.	**Secure parts for the Distribution Center** (see Chapter 3, page 13, under Opportunity #2)	NOW	None	None	$150,000	Would require a decision package.	Addresses Goal 3 of Strategic Plan, "Maximize revenues to the state's taxpayers" Strategy: "Optimize retail outlet resources to serve the public Solution: Subparagraph 9, "Implement Improvements to the Material Handling System at the Distribution Center"

Distribution efficiencies--continued:

	OPPORTUNITY	TIME PERIOD	PROJECTED SALES INCREASE	PROJECTED ADDITIONAL TAXES AND NET INCOME	INVESTMENT ($ and FTEs)	RCW, WAC, AND/OR DECISION PACKAGE REQUIRED?	HOW OPPORTUNITY FITS INTO LCB STRATEGIC PLAN
15.	**Reduce inventory levels at the stores** (see chapter 3, page 11)	NOW	See Opportunity #10, "Reduce Costs of Goods Sold"	See Opportunity #10, "Reduce Costs of Goods Sold"	None, use existing resources	No	Addresses Goal 3 of Strategic Plan, "Maximize revenues to the state's taxpayers" Strategy: "Optimize retail outlet resources to serve the public" Solution: Subparagraph 6, "Implement Improved Inventory Management and Reduce Out of Stocks"

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Technology enhancements:

	OPPORTUNITY	TIME PERIOD	PROJECTED SALES INCREASE	PROJECTED ADDITIONAL TAXES AND NET INCOME	INVESTMENT ($ and FTEs)	RCW, WAC, AND/OR DECISION PACKAGE REQUIRED?	HOW OPPORTUNITY FITS INTO LCB STRATEGIC PLAN
16.	**Fully implement the Merchandising Business System (MBS)** (see Chapter 4, pages 2-4)						Addresses Goal 3 of Strategic Plan, "Maximize revenues to the state's taxpayers" Strategy: "Optimize retail outlet resources to serve the public" Solution: Subparagraph 2, "Implement management tools to minimize expenses" Addresses Goal 6 of Strategic Plan, "Deliver quality and efficient services and information through improved technology" Strategies: "Continue to invest in networking infrastructure to optimize LCB's ability to conduct business effectively, especially relating to state liquor stores" and "Review and replace or upgrade financial software applications as needed."
	Install the MBS at all 157 state stores	NOW	Included in other opportunities	Included in other opportunities	None, us existing resources	No	
	Extend MBS to contract stores	06 to 07	Under review	Under review	Under review	Would require a Decision Package	
	One overall financial data tracking system	04 to 05	None	None, use existing resources	None, use existing resources	No	
	Enhanced telecommunications network	04 to 05	Included in other opportunities	Under Review	Under Review	Would require a Decision Package	
17.	**Create a web-based order program for licensees** (see Chapter 3, page 6)	03 to 05	Customer service	Under Review	Under Review	Under Review	Addresses Goal 6 of Strategic Plan, "Deliver quality and efficient services and information through improved technology" Strategy: "Delivered enhanced service via the Internet considering Security, accessibility, and cost effectiveness"

Customer service enhancements:

	OPPORTUNITY	TIME PERIOD	PROJECTED SALES INCREASE	PROJECTED ADDITIONAL TAXES AND NET INCOME	INVESTMENT ($ and FTEs)	ROW, WAC, AND/OR DECISION PACKAGE REQUIRED?	HOW OPPORTUNITY FITS INTO LCB STRATEGIC PLAN
18.	**Develop a store siting and leasing strategy** (see Chapter 3, page 5)	NOW	Included under other opportunities	Included under other opportunities	None, within existing resources	No	Addresses Goal 3 of Strategic Plan, "Maximize revenues to the state's taxpayers" Strategy: "Optimize retail outlet resources to serve the public" Solution: Subparagraph 4, "Optimize the potential revenue sources through store location"
19.	**Evaluate & possibly expand stores' customer service training program** (see Chapter 3, page 6)	03 to 05	Customer service	Customer service	None at this time	No	Addresses Goal 3 of Strategic Plan, "Maximize revenues to the state's taxpayers" Strategy: "Optimize retail outlet resources to serve the public" Addresses Goal 7 of Strategic Plan, "Build and strengthen relationships with our customers and stakeholders"
20.	**Support the establishment of a delivery program for licensees** (see Chapter 3, page 7)	03 to 05	Customer service	Customer service	None, will help outsource if feasible	No	Addresses Goal 3 of Strategic Plan, "Maximize revenues to the state's taxpayers" Strategy: "Optimize retail outlet resources to serve the public"
21.	**Revise customer feedback process** (see Chapter 4, page 4)	NOW	Customer service	Customer service	Some investment for new cards, within existing budget	No	Addresses Goal 7 of Strategic Plan, "Build and strengthen relationships with our customers and stakeholders"

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Customer service enhancements--continued:

	OPPORTUNITY	TIME PERIOD	PROJECTED SALES INCREASE	PROJECTED ADDITIONAL TAXES AND NET INCOME	INVESTMENT ($ and FTEs)	RCW, WAC, AND/OR DECISION PACKAGE REQUIRED?	HOW OPPORTUNITY FITS INTO LCB STRATEGIC PLAN
22.	**Annual customer surveys** (see Chapter 4, page 4)	03 to 05	Customer service	Customer service	$25,000 to $50,000 per year	Possibly a Decision Package, depending on method	Addresses Goal 3 of Strategic Plan, "Maximize revenues to the state's taxpayers" Strategy: "Optimize retail outlet resources to serve the public" Addresses Goal 7 of Strategic Plan, "Build and strengthen relationships with our customers and stakeholders"
23.	**Reward employees for performance** (see Chapter 4, page 4)	03 to 05	Customer service	Under review	Under review	Under review	Addresses Goal 3 of Strategic Plan, "Maximize revenues to the state's taxpayers" Strategy: "Optimize retail outlet resources to serve the public Addresses Goal 5 of Strategic Plan, "Develop, recruit, retain, and value a high quality diverse workforce"
	Estimated Biennial Totals		$29,208,000	$17,210,575	$3,429,082		

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